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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. 583

EILEEN JUNE MCDONALD THOMPSON, EXECUTRIX OF THE ESTATE OF D. G. MCDONALD, DECEASED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 113-142) are reported at 19 T. C. 672. The opinion of the Court of Appeals (R. 201-216) is reported at 225 F. 2d 621.

JURISDICTION

The judgment of the Court of Appeals was entered on September 16, 1955. (R. 217.) A petition for rehearing was denied on October 10, 1955. (R.

228.) The petition for a writ of certiorari was filed on December 21, 1955. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254(1).

QUESTION PRESENTED

By a property settlement incident to a divorce from his then wife, Lenore McDonald, the decedent, D. G. McDonald, created an *inter vivos* trust for the benefit of his two children. Decedent retained broad powers of control over the trust, including the power, when exercised with the concurrence of Lenore McDonald, to alter, amend, or revoke. On the basis of Sections 811(d)(2) and 811(i) of the Internal Revenue Code of 1939, the courts below permitted, for estate tax purposes, a deduction from the gross estate of an amount ($30,000) determined to be the value of the children's right of support viewed prospectively from the time of the settlement.

The question presented is whether the ascertained value of the right of support represents, as the courts below held, the maximum amount which may be deducted from the gross estate, or whether, as petitioner urges, there should be deducted from the gross estate a percentage of the value of the trust fund at the time of decedent's death equivalent to the ratio between $30,000 and the value of the trust assets at the time the trust agreement became operative.

STATUTE AND REGULATIONS INVOLVED

The relevant portions of Sections 811(d)(2) and (3), 811(i) and 812(b)(3) of the Internal Revenue Code of 1939, and Sections 81.15, 81.20(a)

and 81.20(b)(2) of Treasury Regulations 105, are set forth in the Appendix, *infra*, pp. 14-19.

STATEMENT

The material facts, as stipulated and found by the Tax Court (R. 48-53, 114-131), may be summarized as follows:

D. G. McDonald died on May 16, 1947, and his then wife, Eileen June McDonald (now Mrs. Thompson), was appointed executrix of his estate. On November 10, 1930, decedent had created a trust, known as Trust No. 924, Bank of America National Trust and Savings Association, for the benefit of Delos McDonald, his son by a former marriage to Lenore McDonald (from whom decedent was separated in September, 1930, and divorced on December 7, 1931). Delos was born on December 13, 1914. (R. 53-61, 114, 119.)

Decedent reserved the right to change or amend any of the provisions of the trust and to revoke the trust, in whole or in part, on written notice to the trustee signed by him and by Lenore. (R. 121-122.)

When the trust was created, decedent transferred 12,000 shares of J. C. Penney Company common stock to the trustee as the corpus of the trust. The trust was amended and partially revoked by an instrument dated November 30, 1931, under which certain of the Penney shares were to be transferred to Lenore, and additional shares were to be added to the trust. The amended trust agreement directed the trustee to hold the trust estate in the proportions of six-sevenths for the

benefit of the son Delos and one-seventh for the benefit of Nedra, a legally adopted daughter of decedent and Lenore, whose birth date was October 2, 1925. The net income of the share held for the benefit of Delos was distributable to Lenore until Delos attained the age of 21 years; thereafter, and until he reached 25, $3,600 per year was payable to Delos and the remainder to Lenore. When Delos reached the age of 25 the trustee was to distribute all the net income from his share to Delos, and since December 13, 1939, it has been so distributed. The net income of the share held for the benefit of Nedra was distributed to Lenore until Nedra attained the age of 18 years on October 2, 1943, and since then all the income from her share has been distributed to Nedra. (R. 119, 126-127.)

The principal of the share of the trust estate held for the benefit of each child was to be distributed to the child for whom it was held upon such child's attaining the age of 35 years. (R. 127.)

Article XI of the trust instrument added by the amendment of November 30, 1931, provided (R. 128):

> D. G. McDonald, the Trustor, and Lenore E. McDonald, his wife, agree that the provisions of the trust as hereby amended are made pursuant to the terms of a property settlement settling the rights of the parties; that the income to be paid to the said Lenore E. McDonald from the trusts created for the benefit of said Delos McDonald and the said Nedra McDonald, respectively, shall be considered as full satisfaction of any and all legal obliga-

> tion of the said D. G. McDonald for the support and maintenance of the said children; that the said payments of income to said Lenore E. McDonald are for the purpose of supporting, educating and maintaining the said children, and that the said Lenore E. McDonald assumes full responsibility of educating, maintaining and furnishing a home for the said children.

The amendment to the trust was made part of the property settlement agreement executed on the same day, which in turn was incorporated in the subsequent divorce decree. (R. 123-124, 126.)

On November 30, 1931, the assets of Trust No. 924 consisted of 6,500 shares of the J. C. Penney Company common stock. On that date the market quotation of the J. C. Penney stock was a high of 32¼ and a low of 31. On February 6, 1932, pursuant to the settlement agreement, another 500 shares were added. (R. 50, 123.) The assets of the trust on May 16, 1947, the date of decedent's death, consisted of 21,000 shares of J. C. Penney common stock, there having been a three for one split-up of the Penney shares in 1945. The fair market value of the 21,000 shares on this latter date was $829,500. (R. 50, 51.)

The Court of Appeals affirmed the Tax Court's determinations of various issues, holding, so far as is now material, that the excess of the fair market value of the trust at the time of death over that portion of the trust assets representing the value of the children's right to support should be included

in the gross estate, on the basis that such excess constitutes a transfer not made "for an adequate and full consideration in money or money's worth" within the meaning of Sections 811(d)(2) and 811(i) of the Internal Revenue Code of 1939. In this connection the Court of Appeals approved the Tax Court's finding that the prospective value of the children's right to support was $30,000. (R. 51, 131, 138-139, 211-213.)

ARGUMENT

1. Petitioner does not challenge the determination that the decedent retained powers of control over the trust. It follows, under the plain terms of the Code, that the trust property was a part of the decedent's gross estate and subject to estate tax, save to the extent that property in the trust was placed there for "consideration in money or money's worth." Sections 811(d)(2) and 811(i), *infra,* pp. 14-16. The cited sections provide in substance that, even though a settlor retains, under a trust instrument, powers of control over trusteed property, the trust corpus will not be taxed to his estate to the extent that there was actual consideration for the transfer of property to the trust. Save for this exception, the property in a revocable *inter vivos* trust is regarded as effectively retained by the settlor during his lifetime and as constituting part of his taxable gross estate on his death.[1]

As indicated in the Statement, *supra,* pages 3-5,

[1] See, also, the pertinent Treasury Regulations set forth *infra,* pp. 17-19.

and as more fully set forth in the findings and opinion of the Tax Court (R. 113-142), the trust arrangements made at the time of decedent's divorce from Lenore McDonald in 1931 served a combination of purposes: the agreement provided that for designated periods there should be a distribution of trust income to Lenore for purposes of supporting the minor children; that, thereafter, the children should receive trust income directly; and that, ultimately, the principal would be divided between the children. As stated by the Tax Court, the agreement took care of the children's support, but it also went far beyond that and "had aspects of a testamentary disposition" (R. 138).

The Tax Court accordingly took the view (in which the Court of Appeals concurred) that, insofar as Lenore assumed responsibility to provide for the support of the children, there was, *pro tanto,* consideration, and that, to this extent, there might be a deduction from gross estate. (R. 137-138.) The problem, it held, was one of ascertaining the value of the children's right of support. The Tax Court made that determination of fact on the basis of the evidence before it, finding (R. 139) that the "reasonable prospective value" of the children's right of support as of the time that the trust arrangements were consummated was $30,000 (a finding sustained by the Court of Appeals, R. 213).[2]

On this basis, a deduction of $30,000 from the gross estate was permitted. This deduction is in

[2] That determination, of course, was one primarily for the Tax Court. *Hormel* v. *Helvering,* 312 U.S. 552, 556.

accord with the explicit terms of the statute, which provides that there shall be deducted from the "fair market value" of the gross estate "at the time of death" the "value of the consideration" which the decedent "received" for the *inter vivos* transfer in question. Section 811(i), *infra,* pp. 15-16.

As we understand the petition, petitioner no longer challenges the determination that the capitalized value of the children's prospective right of support was $30,000. She says, rather, that the corpus of the trust, worth $829,500 at the decedent's death in 1947, was worth only $220,000 when the settlement agreement was reached in 1931, and that, instead of deducting $30,000 from $829,500, one should deduct a percentage (13.636%) representing the ratio of $30,000 to $220,000—a method which results in a deduction of approximately $113,000.

For this method there is no support in the statute. The consideration *"received", i.e.,* the value of the right of support, has been determined below, and it is $30,000. It is that consideration, and that alone, which the statute authorizes as a deduction.

Moreover, petitioner's argument is not only inconsistent with the statutory language but with the entire rationale of the statute. The unmistakable purpose of the deduction provision is to allow the estate to subtract from the corpus of a revocable *inter vivos* trust created by the decedent an amount equivalent to the money's worth consideration "received" by the decedent. Decedent did not receive the stock he placed in the trust. It is thus entirely immaterial, for present purposes, that a block of

trusteed stock worth $30,000 in 1931 was worth four times as much in 1947, when decedent died. To the extent that the stock in the trust appreciated in value, the decedent's estate appreciated. The value of the children's right of support certainly did not vary with the stock's quotations. The value of that right, computed on insurance principles, *i. e.,* with regard to the age of the children, the nature of their needs and requirements, etc., has been appraised at $30,000. That is the maximum obligation which the wife assumed (if, indeed, the Tax Court was correct in assuming that she undertook any real obligation beyond the purely fiduciary one of applying the trust income to the children's support).[3] The measure of this obligation, it should be stressed, has nothing to do with the trust property, its character, or its fluctuations.

2. Petitioner urges that this Court grant certiorari on the basis of an asserted conflict with a single case, *Helvering* v. *United States Trust Co.,* 111 F. 2d 576 (C.A. 2), certiorari denied, 311 U.S. 678. An examination of that case does not indicate that there exists a conflict of decisions requiring resolution by this Court.

The decedent in the *United States Trust* case set up an *inter vivos* trust for the benefit of a divorced wife, the wife in turn relinquishing rights arising out of the marriage and assuming the obligation to provide for a minor child of the marriage. A joint power to revoke the trust was reserved. The Com-

[3] The Commissioner had included the entire value of the trust assets in the decedent's gross estate. (R. 134.)

missioner took the view that the entire trust fund was includible in the husband's gross estate at his death, while the estate contended that none of it was to be included. The Court of Appeals disagreed with both contentions. It held that the wife's relinquishment of marital rights could not be deemed consideration (a) because Section 804 of the Revenue Act of 1932, 47 Stat. 169, provides that "a relinquishment . . . of . . . marital rights in the decedent's property or estate, shall not be considered to any extent a consideration 'in money or money's worth,' " and (b) because such provision might be constitutionally applied in a case in which the decedent died after 1932, even though the trust agreement antedated Section 804 (111 F. 2d at 577-578). The court held, however, that, insofar as property was transferred to the trust in consideration of the wife's promise to relieve the husband of the obligation to support the child, there was a consideration for money's worth, and that the amount of this consideration might be deducted from the gross estate (p. 578). Taxpayer petitioned to this Court, challenging the Court of Appeals' holding in relation to Section 804, and this Court denied certiorari. 311 U.S. 678.

Thus far, of course, there is no disagreement between the holding in the *United States Trust* case and the decision in the instant case. There is, however, something further in the Second Circuit's decision upon which petitioner here relies. The Court of Appeals noted in *United States Trust* that the Board of Tax Appeals had not made a finding as

to the cost of the child's support. It accordingly remanded. And, in this connection, it stated (p. 579):

> When the Board has found that value it will find what proportion it represented of the value of the trust fund when it was set up on June 12, 1929. The tax will be then computed by excluding from the gross estate that proportion, but only that proportion, of the value of the trust fund when the testator died.

This language, petitioner argues, supports the contention that $113,000, rather than $30,000, should be deducted from the gross estate of D. J. McDonald.

It is to be emphasized, however, that in making the above-quoted statement in connection with the remand, the Court of Appeals was dealing with a point, *i.e.*, apportionment of the fund, which had not been briefed or argued by the parties, who had urged, respectively, that all or none of the fund was includible in the estate.[4] It is not clear that the Court of Appeals, in making the statement upon which petitioner here relies, was fully mindful of its consequences in relation to a situation characterized by a marked fluctuation in the value of the trust assets as between the date of creation of the trust and the date of the settlor's death. In the *United States Trust* case, it does, concededly, appear from the record that there had been, in

[4] We have lodged with the Clerk copies of the briefs filed in that case with the Court of Appeals.

fact, a fluctuation—a depreciation of value (approximately 25%) rather than an appreciation, as here. See record in No. 328, October Term, 1940, p. 71. Thus the apparent consequences of the court's statement were adverse to the taxpayer. But the taxpayer did not file a petition for rehearing in the Court of Appeals in order to bring this point to the court's attention, and the petition for a writ of certiorari filed with this Court makes no mention of it whatever.

In sum, we believe that the plain import of the statute required the conclusion reached by the court below in the instant case, *i.e.*, that the maximum deduction which might be permitted was the amount representing the appraised value of the children's right of support. And we seriously doubt that the Second Circuit's *United States Trust* decision, insofar as it touches this point, may be deemed a considered and authoritative expression of a contrary view.

CONCLUSION

The decision below is correct and the point raised by petitioner is not one as to which there is a serious or confirmed conflict requiring resolution by this Court. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JANUARY 1956.

APPENDIX

Internal Revenue Code of 1939:

SEC. 811. GROSS ESTATE.

The value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States—

* * * * *

(d) *Revocable Transfers*—

* * * * *

(2) *Transfers on or Prior to June 22, 1936.*—To the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power, either by the decedent alone or in conjunction with any person, to alter, amend, or revoke, or where the decedent relinquished any such power in contemplation of his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth. Except in the case of transfers made after June 22, 1936, no interest of the decedent of which he has made a transfer shall be included in the gross estate under paragraph (1) unless it is includible under this paragraph;

(3) *Date of Existence of Power.*—For the purposes of this subsection the power to alter, amend, or revoke shall be considered to exist on the date of the decedent's death even though the exercise of the power is subject to a precedent giving of notice or even though the alteration, amendment, or revocation takes effect only on the expiration of a stated period after the exercise of the power, whether or not on or before the date of the decedent's death notice has been given or the power has been exercised. In such cases proper adjustment shall be made representing the interests which would have been excluded from the power if the decedent had lived, and for such purpose if the notice has not been given or the power has not been exercised on or before the date of his death, such notice shall be considered to have been given, or the power exercised, on the date of his death.

* * * * *

(i) *Transfers for Insufficient Consideration.*—If any one of the transfers, trusts, interests, rights, or powers, enumerated and described in subsections (c), (d), and (f) is made, created, exercised, or relinquished for a consideration in money or money's worth, but is not a bona fide sale for an adequate and full consideration in money or money's worth, there shall be included in

the gross estate only the excess of the fair market value at the time of death of the property otherwise to be included on account of such transaction, over the value of the consideration received therefor by the decedent.

* * * * *

(26 U.S.C. 1952 ed., Sec. 811.)

SEC. 812. NET ESTATE.

For the purpose of the tax the value of the net estate shall be determined, in the case of a citizen or resident of the United States by deducting from the value of the gross estate—

* * * * *

(b) *Expenses, Losses, Indebtedness, and Taxes.*—Such amounts—

* * * * *

(3) for claims against the estate,

* * * * *

as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered, * * *.

For the purposes of this subchapter, a relinquishment or promised relinquishment of

dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in the decedent's property or estate, shall not be considered to any extent a consideration "in money or money's worth."

* * * * *

(26 U.S.C. 1952 ed., Sec. 812.)

Treasury Regulations 105, promulgated under the Internal Revenue Code of 1939:

Sec. 81.15. *Transfers during life.*—The following classes of transfers made by the decedent prior to his death, whether in trust or otherwise, if not constituting bona fide sales for an adequate and full consideration in money or money's worth, are subject to the tax: * * * (5) transfers under which the enjoyment of the transferred property was subject at decedent's death to a change through the exercise, either by the decedent alone or in conjunction with another person or persons, of a power to alter, amend, revoke, or terminate, or where such a power was relinquished in contemplation of decedent's death (see sections 81.20 and 81.21).

* * * * *

To constitute a bona fide sale for an adequate and full consideration in money or money's worth the transfer must have been made in good faith, and the price must have been an

adequate and full equivalent reducible to a money value. If the price was less than such a consideration, only the excess of the fair market value of the property (as of the date of decedent's death, or as of the applicable date under such an election as is mentioned in the last preceding paragraph) over the price received by the decedent should be included in ascertaining the value of the gross estate. For the purposes of the tax a relinquishment or promised relinquishment of dower, curtesy, or of a statutory estate created in lieu of dower or curtesy, or of other marital rights in decedent's property or estate, is not to any extent a consideration in money or money's worth.

* * * * *

Sec. 81.20. *Transfers with power to change the enjoyment.*—(a) *Transfers included.*—Subsection (d) of section 811 embraces a transfer by trust or otherwise (if not amounting to a bona fide sale for an adequate and full consideration in money or money's worth) when at the time of decedent's death the enjoyment of the transferred property, or some part thereof or interest therein, was subject to any change through a power exercisable either by the decedent alone, or by him in conjunction with some other person or persons, to alter, or amend, or revoke, or terminate. (See section 81.15.)

* * * * *

(b) *Taxability.*—The property or any interest therein transferred as described in subsection (a) shall be included in the gross estate if it comes within any one of the following paragraphs:

* * * * *

(2) If the transfer was made after the enactment of the Revenue Act of 1924 (4:01 p.m., eastern standard time, June 2, 1924) and before the amendment of the subdivision by the Revenue Act of 1936 became effective (June 23, 1936), and the power was reserved at the time of the transfer and was exercisable by the decedent alone or in conjunction with a person or persons either having or not having a substantial adverse interest or interests in the transferred property, or in conjunction with persons one or more of whom had and one or more of whom had not such an adverse interest.

* * * * *

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